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December 18, 2000

BY COURIER

Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of the Secretary
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Re: Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*

Dear Secretary Williams:

In accordance with the Board's Decision served October 3, 2000, enclosed for filing in the above-captioned proceeding are the original and 25 copies of the Reply Comments of Norfolk Southern in Response to Notice of Proposed Rulemaking. Also enclosed is a computer diskette containing an electronic copy of this document in WordPerfect 9.0 format.

Also enclosed is an additional copy to be date-stamped and returned to our messenger. Thank you for your assistance in this matter.

Very truly yours,

Donald H. Smith

G. Paul Moates
Donald H. Smith

cc: George A. Aspatore

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ORIGINAL

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF NORFOLK SOUTHERN IN
RESPONSE TO NOTICE OF PROPOSED RULEMAKING

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DATED: December 18, 2000

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF NORFOLK SOUTHERN IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING

Pursuant to the Board's Notice of Proposed Rulemaking ("NPR"), served October 3, 2000, Norfolk Southern Corporation and Norfolk Southern Railway Company (jointly, "NS" or "Norfolk Southern") respectfully submit these reply comments on the Board's proposed modifications to its regulations governing proposals for major rail consolidations.[1]

INTRODUCTION AND SUMMARY

The Board received opening comments from approximately 90 parties representing a broad spectrum of interests, including major railroads like NS, smaller carriers, rail customers, employees, government agencies and officials and other constituencies. The comments reflected relatively broad-based support for the Board's proposals to place greater emphasis in the merger

[1] Unless otherwise noted, abbreviations used in these comments conform to those listed in Appendix A of the NPR (at 69-76). Opening comments filed in response to the NPR will be cited by party name abbreviation and "NPR Opening" (*e.g.*, "NS NPR Opening at 4"). Opening and reply comments filed in response to the Board's March 31, 2000 Advance Notice of Proposed Rulemaking ("ANPR") will be cited by party name abbreviation, "ANPR Opening" or "ANPR Reply," respectively, and page number (*e.g.*, "NS ANPR Opening at 5" and "NS ANPR Reply at 5"). As in its prior submissions in this docket, NS uses the term "merger" as a shorthand reference to all mergers, consolidations, acquisitions of control and other combinations, involving two or more Class I rail carriers, that are subject to Board review under 49 U.S.C. §§ 11321-11326. NS incorporates by reference its ANPR Opening and Reply Comments, and also adopts the separate comments filed by AAR and NRLC.

review process on improving the level and quality of service that railroads provide to their customers, to give more critical scrutiny to claims of merger-related public benefits, to codify and make more systematic the Board's approach to merger implementation and transitional service problems, and to expand the public interest analysis to embrace transnational impacts on competition, operations and service. NS believes that the Board's proposed rules on these subjects, with minor changes and clarifications, will improve the overall quality and accuracy of the merger review process. NS is also optimistic that these new rules may provide a vehicle for the various constituencies having an interest in the future structure and health of the railroad industry to find some valuable common ground on merger-related issues, particularly with respect to the important question of preserving rail service quality during the transitional merger implementation period.

The opening comments produced no consensus, however, with respect to the Board's unprecedented proposal to require future rail merger applicants to accept measures to "enhance" rail-to-rail competition, unrelated to the amelioration of any direct merger-related losses of competition, as a condition to approval of any future transaction. Major railroads (including NS) opposed this requirement of mandatory non-remedial competitive enhancements as an unwarranted departure from the established principle in the railroad (and every other) industry that regulatory review of proposed mergers should be confined to the identification and amelioration of direct, competitive harms resulting from the transaction rather than the use of a merger to effectuate a broad regulatory restructuring of the competitive conditions of an industry. DOT similarly agreed that merger review should focus first on remedying direct transaction-related competitive harms, and that only if these identified harms cannot practicably be remedied through conditions would it be appropriate to consider whether they are outweighed by the anticipated public benefits of the proposed transaction (including competitive enhancements). DOT NPR Opening at 3-4.

Most shipper (and short-line railroad) interests also opposed the Board's proposed requirement of "enhanced competition," but on the opposite ground that the Board's proposals did not go far enough in imposing specific requirements for rail merger applicants to submit to various forced-access and other regulatory measures to manufacture additional direct rail-to-rail competition that market conditions have not supported. These comments included renewed calls for imposition of forced access in a plethora of different forms, including mandatory grants of trackage and haulage rights to other carriers, forced switching access at terminals and interchange points, overruling of the Board's "bottleneck" rate decision, mandatory preservation of open gateways, elimination of contractual provisions in line sale and trackage rights agreements governing traffic interchanges, and numerous other proposals. Virtually all of these proposals had been raised in the ANPR comments but were rejected by the Board.

The opening comments only strengthen NS's belief that the Board's proposed requirement of non-remedial "enhanced competition" is unsound as a matter of law and policy, and simply unworkable in practice. Even a cursory review of the large number and breadth of the various proposals for restructuring rail-to-rail competition through forced-access measures demonstrates that they are not genuinely merger-related at all. Most forced-access advocates make little (if any) attempt to connect their re-regulatory proposals to actual merger impacts. Some unabashedly suggest that the Board should not limit the requirement of "enhanced competition" to merger applicants, but should instead extend it to the entire rail industry. Few commenting parties attempt to defend the Board's reliance on misguided presumptions of merger-related harms as a basis for imposing mandatory "enhanced competition" conditions, or make any effort to connect proposed competition-enhancing conditions to actual merger harms. As NS has previously explained, because there is no nexus between the proposed requirement of "enhanced competition" (as proposed by the Board or as advocated by various shipper interests) and actual merger-related losses of competition, there is no standard for determining which shippers should receive "enhanced competition" and which should not. The opening comments leave no doubt that any requirement of mandatory non-remedial "enhanced competition" is likely to embroil merger proceedings in endless demands, unconstrained by any intelligible or principled standards, for the very kind of "open access everywhere" the Board has already found (correctly) to be beyond its statutory authority to impose in the railroad industry. Even if the Board had such authority, imposition of forced access could be harmful to the rail industry's financial viability and thus contrary to the public interest, as DOT candidly acknowledged in its comments. DOT NPR Opening at 4-5.

The Board should not go down the path of requiring merger applicants to submit to measures for "enhanced competition" unrelated to the remediation of direct merger-related competitive harms. Each rail merger proposal should be evaluated on its own individual merits, based on evidence addressed specifically to its impacts and, as DOT also agreed, should not be judged on the basis of inflexible and unsubstantiated presumptions that all rail mergers will produce irremediable competitive harms or that they will not produce significant benefits. DOT NPR Opening at 3-4. Under this standard, the Board should welcome and encourage rail consolidations that enhance competition -- including genuine rail-to-rail competition -- but those proposals should, as the statutory scheme directs, come from voluntary market-based initiatives, not regulatory edict.

In addition to the various proposals for forced-access conditions, the opening comments included many requests for adoption of rules that would place onerous (if not insuperable) evidentiary requirements on rail merger applicants or saddle future mergers with burdensome and costly conditions. In many instances, these proposals seek to use the prospect of future rail mergers as an opportunity to advance parochial commercial or competitive interests at the expense of the railroads, or to achieve through regulation commercial protections from competitive market forces having little, if anything, to do with any actual harmful impacts of railroad mergers. Even when these proposals relate to potential merger impacts, they would effectively prejudge the issues of adverse effects and potential remedies with inflexible rules, and prevent case-by-case consideration of these issues and weighing of merger benefits and harms in individual cases. Adopting these proposals would increase unreasonably the cost of future rail mergers, deter even beneficial, efficient railroad consolidation proposals and, ultimately, disserve the public interest.

More generally, NS is concerned that, if the Board's proposed merger rules are expanded (as some commenters request) to impose even more burdensome evidentiary requirements and to require even more detailed and costly protective conditions in favor of a host of different constituencies, the very process of rail merger review will become unduly long, complicated, uncertain and, ultimately, unmanageable. Railroad mergers already are subject to the most comprehensive and most time-consuming regulatory review process of any U.S. industry. The trend in all other industries, recognizing that regulatory delay and uncertainty discourages beneficial consolidation transactions and market-driven restructurings, is to shorten and streamline merger review. The Board's statutory duty to review proposed rail mergers for consistency with the public interest unquestionably demands careful and intensive scrutiny of each rail merger proposal. But the Board should be looking for ways to streamline and accelerate the merger review process, and not to make it even more protracted, costly and uncertain than it already is. For this reason, NS supports the proposals by several parties to expedite rail merger review and, in particular, the adoption of a policy favoring completion of such review within one year.[2]

DISCUSSION

The opening comments filed in response to the NPR contain numerous, varied and often overlapping requests for specific changes in the Board's proposed new merger rules and suggestions for how the rules should be interpreted or applied in future rail merger proceedings. Many of the arguments and proposals for changes in the Board's merger rules, however, repeat points that were raised and discussed at considerable length in the ANPR comments. For example, the proposals about which NS has the greatest concerns -- such as the proposals to require specific forced-access or other measures to "enhance" rail-to-rail competition as a condition to merger approval, mandatory service guarantees and penalties for merger-related service disruptions, and mandatory protective conditions favoring short-line railroads and other

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[2] NS's proposals to reform the Board's procedures for assessing the environmental impacts of a proposed major rail consolidation would also serve to streamline the merger review process and accomplish similar purposes. *See* NS NPR at 53-57.

parties -- were raised by many parties during the ANPR process and, clearly, were *not* adopted by the Board.[3]

NS's prior submissions in this proceeding responded in detail to most of these proposals. For the most part, the opening NPR comments have offered nothing new on these subjects. Accordingly, rather than burden the Board with a detailed response to all of the opening comments, NS will focus here on the major issues raised in the comments and summarize NS's position on these issues.[4]

I. COMPETITIVE EFFECTS

The centerpiece of the Board's proposed "paradigm shift" (NPR at 10) in its approach to review of major rail consolidations is its proposed change in the way it assesses the competitive effects of a proposed combination. Not surprisingly, the Board's unprecedented proposal to require non-remedial "enhanced competition" as a condition to approval of future rail mergers and its proposed rules for preserving existing competition both elicited widespread comment.

A. The Proposed Requirement of "Enhanced" Competition

The Board's proposed new merger rules would radically alter existing law by imposing an absolute requirement that rail carriers proposing *any* major rail consolidation

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[3] Because these and other significant proposals were not adopted by the Board and included in its proposed rules, they could not be incorporated in the Board's final merger rules without additional notice and opportunity for public comment. *See* 5 U.S.C. §§ 553(b), (c); *American Water Works Ass'n v. EPA*, 40 F.3d 1266, 1275 (D.C. Cir. 1994); *Anne Arundel County v. EPA*, 963 F.2d 412, 418 (D.C. Cir. 1992); *Natural Resources Defense Council, Inc. v. EPA*, 863 F.2d 1420, 1429 (9th Cir. 1988).

[4] The Board therefore should not interpret NS's failure to respond here to a particular proposal or argument raised in the opening comments as indicating any acceptance or rejection of such position.

affirmatively provide for what the Board terms "enhanced competition" -- unrelated to the existence, much less the amelioration, of any direct merger-related competitive harms -- or face the prospect of involuntary competition-enhancing conditions imposed by the Board. NS strenuously opposed the Board's proposed requirement of "enhanced competition" on a variety of grounds, and urged that the Board's competitive-impact review of proposed rail mergers should instead continue to be focused on identifying and remedying direct competitive losses resulting from a particular transaction. NS NPR Opening at 11-36. Other major railroads, as well as DOT and some other parties, generally agreed with this position.[5]

Most commenting shippers and short-line railroads, as well as some government agencies, by contrast, strongly supported the idea of requiring railroad merger applicants to submit to conditions imposing non-remedial "enhancements" of competition. But these parties expressed varying degrees of dissatisfaction with the Board's proposed rules because they did not go far enough in mandating specific forced-access or other measures to use regulation to manufacture increased rail-to-rail competition.[6] The range and scope of the various specific competition-enhancing conditions these parties proposed are sweeping:

- Mandatory shipper access to at least two railroads everywhere, with the terms of such access prescribed by Board regulation;[7]

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[5] BNSF NPR Opening at 36-43; CP NPR Opening at 8-15; CN NPR Opening at 11-15; CSX NPR Opening at 25-50; UP NPR Opening at 12-13; AAR NPR Opening at 6-19; KCS NPR Opening at 12-13; DOT NPR Opening at 3-5; Port of Seattle NPR Opening at 2.

[6] *See, e.g.*, AGP NPR Opening at 2; ASLRRA NPR Opening at 2-3; BASF NPR Opening at 4-6; Bunge NPR Opening at 4; CPPA NPR Opening at 2; CCS NPR Opening at 2-4; CURE NPR Opening at 4-5, 7-9; DuPont NPR Opening at 3-5, 6-7; EEI NPR Opening at 1-3; Kansas Agencies NPR Opening at 1; NITL NPR Opening at 3, 11-12; SCS NPR Opening at 5-6; TFI NPR Opening at 3, 6-8.

[7] *See, e.g.*, ACC NPR Opening at 4-5; SCS NPR Opening at 14-15.

- Mandatory preservation of open gateways with Board regulation of rates to ensure rate equality over competing routes;[8]

- Mandatory reciprocal switching and trackage rights with Board prescription of rates and charges;[9]

- Overruling of the Board's "bottleneck" rate decision and requirement that railroads on demand quote rates between any two points on their systems, with Board regulation of the reasonableness of such rates;[10]

- Mandatory establishment of contract rates for movement over non-bottleneck segments, again subject to enforcement through Board regulation;[11]

- Forced divestiture of railroad terminal facilities to "neutral" operators;[12]

- Rail line divestitures to ensure multiple carrier access;[13]

- Elimination of contractual provisions in railroad line sale and trackage rights agreements governing interchange of traffic between railroads ("paper" and "steel" barriers);[14]

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8 *See, e.g.*, PPG NPR Opening at 2; Bunge NPR Opening at 4-6; Shell NPR Opening at 10; Weyerhaeuser NPR Opening at 6; Ameren NPR Opening at 3; ACC NPR Opening at 3-4; EEI NPR Opening at 9-10; NITL NPR Opening at 18-20; Enterprise Products Operating L.P. ("Enterprise") NPR Opening at 5-7.

9 *See, e.g.*, CCS NPR Opening at 18; CURE NPR Opening at 4-5, 8-9; Dow NPR Opening at 7-8; MW&BC NPR Opening at 5-6; TFI NPR Opening at 9-10.

10 *See, e.g.*, ACC NPR Opening at 6-8; CCS NPR Opening at 13-16; PPG NPR Opening at 2; CURE NPR Opening at 4-5, 8; EEI NPR Opening at 6-8; MW&BC NPR Opening at 5-6; SCS NPR Opening at 16-18.

11 *See, e.g.*, Martin Marietta NPR Opening at 6; Enterprise NPR Opening at 9.

12 *See, e.g.*, NITL NPR Opening at 12; POHA NPR Opening at 3, 5-6.

13 *See, e.g.*, IMPACT NPR Opening at 23-25.

14 *See, e.g.*, ASLRRA NPR Opening at 3; CCS NPR Opening at 18-19; New York NPR Opening at 14-18; PPL NPR Opening at 15-18; EEI NPR Opening at 8-9; SCS NPR Opening at 18-19; FMRC NPR Opening at 6-7; ODOT NPR Opening at 8-11.

and other measures designed to manufacture a form of increased rail-to-rail competition the marketplace has not supported. Taken together, these proposals (if adopted) would constitute a broad-scale restructuring of the rail industry.

None of these demands for more specific requirements of "enhanced competition" is new. Virtually all of them were proposed in the ANPR comments and were considered, but not adopted, by the Board in fashioning its proposed new merger rules. Because the Board decided not to include these proposals in its proposed rules, they cannot be included in the final rules absent additional notice and opportunity for comment. In any event, the various proposals to require merger applicants to submit to forced-access measures and other non-remedial "enhancements" of rail-to-rail competition are a bad idea, and should not be adopted, for reasons already explained at some length in NS's prior submissions (and in the submissions of AAR and the other major railroads).[15] Rather than repeat this analysis, NS wishes here to emphasize here several key points.

(1) Not Merger-Related. The various demands by shipper and short-line railroad interests for manufactured forms of increased rail-to-rail competition are simply not merger-related, and have no place in the Board's review of proposed major rail consolidations. The various forced-access proposals that have been offered all seek to alter the fact that many shippers are served by only a single railroad. This condition has everything to do with competitive market forces (which in most cases cannot support financially sustainable two-carrier service at particular facilities) and virtually nothing to do with railroad mergers. The Board and the ICC

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15 *See* NS NPR Opening at 11-36; NS ANPR Reply at 37-52; NS ANPR Opening at 39-51; note 5, *supra*.

have taken great care in all recent rail merger proceedings to ensure that proposed mergers would not result in any reduction in the number of railroads serving particular shipper facilities, and to preserve effective rail competition. The agency has also properly recognized that rail consolidations can enhance competition, both through efficiencies and improved service offerings that increase the railroads' ability to compete effectively with each other and with other transportation modes, and through voluntary, market-based proposals (such as the creation of Shared Assets Areas in the Conrail transaction) that expand direct rail-to-rail competition. *See* NS ANPR Reply at 41-45.

Faced with these facts, many supporters of non-remedial "enhanced competition" have simply resorted to sweeping *ad hominem* attacks on the agency's prior record in rail merger cases. But these unfair (and often intemperate) charges cannot be squared with the reality that prior rail mergers have not reduced effective competition but, to the contrary, have preserved and enhanced competition for transportation services.[16] Parties may reasonably debate whether forced access is the answer, but railroad mergers are not the problem.

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[16] Whether due to overheated rhetoric or otherwise, some of the claims made by these commenting parties are truly astounding. For example, DOA complains that railroads are losing market share to other modes (due to poor service), but simultaneously claims that railroads have increased market power as a result of recent mergers. DOA NPR Opening at 3, 6. These assertions are obviously contradictory. In support of its own political agenda, ARC claims that increased market power of the railroads has caused them to discourage and prevent economic development, particularly in rural areas (ARC NPR Opening at 2), an accusation that is both unfair and absurd on its face. *See also* MW&BC NPR Opening at 3. Similarly, PPL charges that it is "undisputable" that since 1980 there has been a "dramatic reduction in the extent and effectiveness of competition faced by major railroads" (PPL NPR Opening at 2), a claim so breathtakingly overstated as to be ridiculous. What is undisputable is that, since 1980, shippers have enjoyed substantial *reductions* in rail rates, in large measure because of the enhanced competitiveness made possible by railroad consolidations. Amidst all these histrionic accusations of rampant rail monopoly abuses, it should also be noted, the record is that the railroad industry continues to generate anemic returns that simply cannot be reconciled with claims of monopolistic excess.

That the demands for broad "enhanced competition" conditions are not truly merger-related is also demonstrated by the scope of the various forced-access proposals that have been advanced. Many of the parties that are asking the Board to impose specific forced-access measures as a condition to future rail mergers are unequivocal in their demand that these measures should be extended to *all* shippers (whether or not their rail service is at all affected by a proposed rail merger) and to all railroads (whether or not they are even a party to the proposed transaction).[17] Indeed, some of these parties insist that it would be unfair and discriminatory for the Board to impose access conditions only on merger applicants, because it would have the effect of favoring some shippers over others, simply because the railroad serving them is involved in a merger proceeding.[18] And some parties argue that, in order to ensure that forced-access measures are extended throughout the rail industry, the Board should reopen its "competitive access" rules or seek legislative changes to permit the imposition of broad "open access everywhere."[19] Whatever the merits of these arguments (and there are none), they confirm that demands for broad conditions for non-remedial competitive "enhancements" are not merger-related.

(2) No Standards or Limiting Principles. In large measure because proposals to require "enhanced" rail-to-rail competition are not truly merger-related, there is no

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17 *See, e.g.*, AF&PA NPR Opening at 5-6; CCS NPR Opening at 11-13; CURE NPR Opening at 3, 5-7; Dow NPR Opening at 5, 6-; DuPont NPR Opening at 1, 4-6; TFI NPR Opening at 3; IMC Global NPR Opening at 6; MW&BC NPR Opening at 2,5; NITL NPR Opening at 15-18. *See also* NS ANPR Reply at 43 & n.38.

18 *See, e.g.*, NITL NPR Opening at 15-18; DuPont NPR Opening at 4-7; NS ANPR Reply at 43-44 & n.39.

19 *See, e.g.*, NITL NPR Opening at 15-18; ARC NPR Opening at 2, 4; DuPont NPR Opening at 7; EEI NPR Opening at 6-8.

principled standard under which the Board could decide whether specific forced-access measures should or should not be imposed as a condition to approval of a rail consolidation proposal. The case for "open access" rests on the proposition that all shippers should be directly served by more than one railroad. But if that misguided proposition were accepted, there would be no basis on which to deny any shipper such dual-access, whether in a rail merger proceeding or otherwise. Imposing on railroad merger applicants a duty to submit to forced-access conditions or other measures to "enhance" rail-to-rail competition would put the Board in the position of deciding which shippers should receive "enhanced competition" and which should not, without any intelligible standards or limiting principles.[20]

The Board's assumption of such a role in the regulatory handicapping of competitive outcomes would be unseemly, inappropriate and unavoidably arbitrary. Once the Board's award of competitive conditions in merger cases is detached from the amelioration of direct, merger-related losses of competition, there would be no principled way for the Board to decide which shippers should receive "enhanced competition" and which should not. The surely inevitable result of the Board's assumption of authority to award competitive benefits of this sort to particular shippers or locations would be to engulf every future rail merger proceeding with endless demands by hosts of shippers for broad "open access everywhere" conditions -- the very relief that the Board has correctly found to be beyond its existing statutory authority. NPR at 16.[21] The only rational way to avoid such a result is for the Board to adhere to the fundamental

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[20] *See* NS NPR Opening at 28-32; NS ANPR Reply at 41-45; BNSF NPR Opening at 41-43; CN NPR Opening at 11-12; CSX NPR Opening at 40-42.

[21] *See also* STB Finance Docket No. 32760 (Sub-No. 26), *Union Pacific Corp. -- Control & Merger*
(continued...)

principle in the railroad industry (and in other industries) that regulatory review of proposed mergers should focus on identifying and remedying direct, merger-related competitive harms.

(3) Not Justified By Presumed Merger Harms and Lack of Merger Benefits. The opening comments offered little, if any, support for the Board's attempt to justify its proposed requirement of non-remedial "enhanced competition" on the ground that such measures are needed to "offset" presumed merger-related public harms (including irremediable losses of competition and transitional service disruptions) or presumed lack of significant merger-related public benefits. NS and other railroads showed that there was no factual support for the Board's various presumptions and that, even if there were, there was no rational connection between the possibility that future mergers would not produce public benefits or would produce irremediable service disruptions or competitive harms, on the one hand, and particular measures to "enhance" rail-to-rail competition, on the other hand.[22]

Shippers and other forced-access advocates, not surprisingly, paid some lip service to the Board's reliance on these presumptions as justification for its proposed requirement of "enhanced competition." But these parties offered no evidence supporting the validity of these presumptions. None offered a coherent explanation why future rail consolidations should be burdened by "enhanced competition" conditions even if they do *not* produce competitive harms or service disruptions and even if they *do* generate significant public benefits. None of these parties

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[21](...continued)
-- *Southern Pacific Rail Corp. [Houston/Gulf Coast Oversight]*, Decision No. 10 (served Dec. 21, 1998), at 2-3; *Union Pacific Corp. -- Control -- Missouri Pacific Corp.*, 366 I.C.C. 459, 564 (1982).

[22] *See* NS NPR Opening at 18-28; AAR NPR Opening at 7-15; BNSF NPR Opening at 23-36; CP NPR Opening at 8-13; CN NPR Opening at 11-15; UP NPR Opening at 12.

identified any nexus between anticipated merger harms and specific "enhanced competition" conditions that might be imposed. Nor did any party identify any means by which the Board could ensure any equivalence or balance between the presumed merger-related harms and lack of merger-related benefits and the "offsetting" benefits from "enhanced competition" conditions.

The determination whether a proposed major rail consolidation is consistent with the public interest should not be based on arbitrary and unsupported *presumptions* that all proposed combinations will produce irremediable harms or will not produce significant public benefits. Each major rail consolidation proposal should be judged on its own merits, and competitive remedies (if any are justified) determined on the basis of the actual effects of the proposed transaction in light of its overall relative benefits and harms. In this regard, NS agrees with DOT that it is premature to presume that future rail mergers will not produce significant public benefits or that future mergers will result in losses of competition that cannot effectively be remedied directly through appropriate mitigating conditions. DOT NPR Opening at 3-4, 16. The Board's merger rules should authorize a case-by-case examination of each merger proposals impacts -- whether beneficial or harmful -- unburdened by arbitrary presumptions.

(4) Not Justified as "Offsetting" Public Benefit. Even if there were merit to the Board's presumptions that future major rail consolidations would not produce significant public benefits and would produce irremediable competitive harms and transitional service problems, it is wrong for the Board to presume that forced-access conditions and other measures to "enhance" rail-to-rail competition would necessarily or invariably produce "offsetting" public *benefits*. As NS's prior discussion of forced-access proposals makes clear, regulatory measures to increase direct rail-to-rail competition (such as trackage rights, switching and other joint use arrangements) can produce other harms to the rail network. These harms include increased operating costs, exacerbation of congestion-related service problems, erosion of the carriers' ability to recover their full economic costs (including fixed and common costs) through differential pricing, and reduced incentives for capital investment. *See* NS ANPR Opening at 41-46. For this reason, imposing increased rail-to-rail competition as a merger condition will not always or invariably produce effects that are uniformly beneficial. To the contrary, they may be affirmatively harmful.[23]

In this regard, NS urges the Board to give careful consideration to the comments of DOT, which candidly acknowledged that the Board's justification for imposing "enhanced competition" conditions is flawed because regulatory measures to increase rail-to-rail competition do not necessarily produce public benefits:

> The Department believes that *enhancing competition does not always produce unalloyed public benefits* in an industry such as the rail industry, which is characterized by decreasing costs and requires differential pricing to recovery full costs. The Board must be certain in its evaluation that competitive enhancements do not result in long-run public disbenefits. Additionally, if competitive enhancements are required to balance potential service implementation problems, the STB must ensure that enhancements do not inadvertently exacerbate merger implementation difficulties through increased congestion.

DOT NPR Opening at 3-4 (footnote omitted) (emphasis added).

DOT's concerns are well taken. It has long been recognized that railroads must be allowed to price their services differentially if they are to have a reasonable opportunity to recover their substantial fixed and common costs. This means charging proportionally higher rates to

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[23] To reflect this fact, NS suggested in its opening comments that the Board include in its proposed merger policy statement on conditions additional language acknowledging the possible conflicting and uneven effects of access conditions. *See* NS NPR Opening at 27 n.11 & Attachment A at 67 (proposed § 1180.1(d)).

those shippers who have fewer competitive alternatives to rail service (subject, of course, to a maximum reasonable rate level under the Board's regulatory standards). Demands by solely served shippers for "enhanced competition" (such as through mandatory trackage rights, switching, bottleneck rate regulation and similar measures) are motivated by a desire to undermine the railroads' ability to price differentially and, through introduction of artificial head-to-head rail competition, drive rate levels down toward marginal or incremental cost, thus eroding (if not eliminating completely) the carriers' ability to recover their fixed and common costs. As DOT notes, regulatory imposition of forced access has potentially dangerous implications for the future viability of the rail industry. It cannot be treated, as the Board's proposed rules suggest, as an unequivocal public benefit.[24]

(5) Constitutes Re-Regulation Beyond Board's Statutory Authority. The myriad proposals for specific forced-access and other "enhanced competition" requirements represent efforts to alter fundamentally the entire structure of regulation of railroad rates and services and, in practical effect, to re-regulate the industry. It is sophistry to suggest, as some shipper interests do, that regulation-imposed forced access to railroad lines and facilities, with

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[24] DOT also suggested in its comments that the railroads' requirement for differential pricing as a means of recovering their fixed and common costs of service could be accommodated with demands for increased rail-to-rail competition over "bottleneck" line segments through an access pricing standard known as the "Efficient Component Pricing Rule." DOT NPR Opening at 6-7 & n.4 (citing Beshers, *Efficient Access Pricing for Rail Bottlenecks*, Hagler Bailley Services, Inc., June 2000). As a theoretical matter, NS agrees that the pricing of rail access (whether for trackage rights, switching access or joint rates) using ECPR would preserve a railroad's ability to price differentially while at the same time creating incentives for efficient routing of traffic. Railroads have been advocating the economic principles underlying ECPR for years, and those principles are based on sound economics. Shipper interests, however, have opposed these principles, precisely because they would not erode the railroads' ability to recover their fixed and common costs through differential pricing and therefore would not drive rate levels down in the manner they seek.

access prices prescribed by regulatory order, is not regulatory. And the demands for broad "enhancement" of rail-to-rail competition proposed by these parties would unquestionably move the railroad industry toward "open access." Whatever the merits of these proposals, they are -- as the Board has consistently stated -- matters for Congress. The Board should not sanction back-door re-regulation of the railroad industry through the guise of rail merger review.

In sum, the Board should reject proposals to require railroad merger applicants in all cases to submit to forced-access and other "enhanced competition" measures. The Board should decide each rail merger proposal on its individual merits, not on the basis of presumptions. It should encourage, and give significant weight in the approval process, to voluntary measures proposed by applicants to enhance rail-to-rail competition, but it should not mandate such measures in all cases.

B. Preserving Effective Competition

As NS has explained, the focus of the Board's competitive analysis of proposed railroad mergers should be, as it has always been, on ensuring that the proposed transaction will not harm competition and that any merger-related loss of effective competition is, if at all possible, remedied through appropriate mitigating conditions. The Board's proposed new merger rules reflect a sound, flexible approach to the analysis of merger-related competitive impacts. They provide that merger applicants must identify and explain how they would remedy anticipated merger-related competitive harms -- including preservation of competitive options for shippers and short-line railroads, preservation of major efficient gateways and opportunities for rail line build-ins and build-outs, and preservation of shipper rights to "bottleneck" rate relief under existing law -- and authorize the Board to balance those harms (if not remedied through conditions) against the proposed transaction's potential benefits in deciding whether the transaction should be approved as consistent with the public interest. *See* NPR at 52-53 (proposed § 1180.6(b)(10)), 53-55 (proposed § 1180.7)). With limited exceptions, the proposed rules on this subject preserve necessary flexibility for the Board to conduct an appropriately intensive case-by-case analysis of a proposed transaction's competitive effects and to adopt appropriately tailored conditions to remedy direct merger-related losses of competition.

Some commenting parties would seek to interfere with this desirable case-by-case approach to the assessment of merger-related competitive harms by imposing a variety of rigid rules that would unreasonably preempt evidentiary consideration of these issues in particular cases, or impose new requirements that would go far beyond the amelioration of direct, merger-related losses of competition. The Board should resist these efforts.

(1) Reductions in Number of Serving Railroads. Several commenting parties have argued that *any* reduction in the number of railroads directly serving a particular facility or shipper (whether 2-to-1, 3-to-2, 4-to-3 or other) should be regarded as a merger-related loss of competition that must be remedied through access conditions if a proposed merger is to be approved.[25] These arguments are flawed for two reasons.

First, the notion that *any* reduction in the number of rail *competitors* necessarily entails harm to *competition* ignores the basic principle of antitrust law (and of railroad merger review) that the focus of analysis should be on the preservation of competition, not competitors.[26]

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25 *See, e.g.*, NITL NPR Opening at 12-13; TFI NPR Opening at 8; ACC NPR Opening at 12; KCS NPR Opening at 8-13; IMPACT NPR Opening at 4-10; EEI NPR Opening at 10-11.

26 *See, e.g.*, *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 (1990); *Brown Shoe* (continued...)

A merger-related reduction in the number of railroads serving a particular shipper or facility may not result in harm to effective competition if the affected shippers continue to enjoy post-merger competitive alternatives (*e.g.*, other competing railroads or modes) sufficient to ensure competitive rates and service. If a particular rail consolidation would reduce the number of railroads directly serving a particular facility, it would be nonsensical to suggest that this effect entails a loss of effective competition requiring a competitive remedy when there remain multiple railroads serving the facility post-merger or other effectively competitive transportation alternatives continue to be available. Whether a merger-related reduction in the number of railroads serving particular shippers or facilities (including so-called "3-to-2" situations)[27] would harm competition should be a matter for evidentiary consideration and decision in each case.[28]

Second, the Board should not require that every merger-related loss of competition must be effectively mitigated or else a proposed railroad merger should be denied. This approach would ignore the appropriate balancing of merger-related benefits and harms. For example, if a proposed merger were projected to generate huge public benefits (such as through improved service, operating efficiencies or enhancement of competition), but would cause some isolated

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[26](...continued)
Co. v. U.S., 370 U.S. 294, 320)1962); STB Ex Parte No. 582, *Public Views on Major Rail Consolidations* (served Mar. 17, 2000), at 3 n.5 ("[w]e fully understand that our mandate is to protect competition, not particular competitors"); *Union Pacific Corp. -- Control -- Missouri-Kansas-Texas Railroad Co.*, 4 I.C.C.2d 409, 460 (1988).

[27] *See* NS ANPR Opening at 32-33; NS ANPR Reply at 32.

[28] *See also* UP NPR Opening at 13-14; CN NPR Opening at 15-16. For this reason, NS agrees with UP's suggestion that the language in proposed § 1180.1(c)(2)(i) stating that "intramodal competition is reduced when two carriers serving the same origins and destinations merge" should be revised to say that competition "may be" reduced in these circumstances, not that it always "is" reduced. UP NPR Opening at 14.

loss of competition that for whatever reason could not practicably be remedied through conditions, it would against the public interest to deny the merger. Merger-related losses of competition should, wherever possible, be remedied. But if they can not, the Board still should weigh the relative benefits and harms of the merger in deciding whether to approve it. If the net public benefits are positive, the proposed combination should be approved.

(2) Maintenance of Efficient Gateways. There was widespread agreement during the earlier phases of this proceeding that railroad mergers should not result in the closure of efficient gateways, and that the Board should scrutinize proposed rail mergers for impacts on efficient gateways. A variety of proposals were offered to ensure the preservation of efficient gateways. NS and other major railroads expressed concern, however, that certain of these proposals were short-sighted, and would have the effect of re-introducing the discredited *DT&I* traffic protective conditions, which were long ago abandoned as inefficient and anti-competitive. NS therefore suggested that the Board adopt a policy of requiring merger applicants to propose measures to ensure the maintenance of major efficient gateways, and to examine these proposed measures during the merger-review process.[29]

The Board wisely adopted NS's proposed approach. *See* NPR at 14-15 (proposed § 1180.1(c)(2)). In doing so, the Board declined to embrace various proposals by shipper and short-line railroad interests to mandate "open" gateways at all locations and to enforce such mandates through requirements of equalized rates over competing single-line and joint-line routes, arbitrary caps on rates for interline shipments or other measures to regulate interline rates and

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[29] *See, e.g.*, NS ANPR Opening at 34-39; NS ANPR Reply at 34-37.

services.[30] Regrettably, many of these proposals resurfaced in the opening comments, with some parties even advancing the remarkable proposal that the Board should impose *DT&I* conditions as a routine matter in future mergers.[31] These proposals make no more sense now, and should be rejected. Railroads have every incentive to route traffic over efficient interline routes unless those incentives are distorted by misguided regulation, such as rate-equalization measures and rate caps proposed by some parties. The Board should examine gateway preservation issues on a case-by-case basis, but should not adopt rigid rules mandating that every gateway be kept open. Turning the regulatory clock back to the days of the *DT&I* conditions, which nearly bankrupted the railroad industry, is not the answer.

(3) Preservation of Shippers' Rights Under "Bottleneck" Rule. During the ANPR comment period, some parties expressed concern that an end-to-end rail merger, by potentially extending the length of so-called "bottleneck" segments, might reduce shippers' rights to separately challengeable rates under the "contract exception" to the general rule that the reasonableness of railroad rates must be tested only for the entire end-to-end through movement between origin and destination.[32] Most parties (including NS) agreed that the Board should

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30 For example, some parties insist that, in order to keep gateways open and prevent what is referred to as "economic" or "commercial" closing of gateways, the Board should require that rates be equalized over competing single-line and joint-line routes. Such a rule, which the ICC long ago rejected as anti-competitive (*see* NS ANPR Opening at 34-35 & n.26), would have the perverse effect of preventing railroads from exploiting the recognized efficiencies of single-line service by offering shippers lower rates over more efficient single-line routes than they offer over less efficient joint-line routes.

31 *See, e.g.*, ACC NPR Opening at 6-7; Bunge NPR Opening at 5-6; EEI NPR Opening at 9-10; NITL NPR Opening at 18-20; Enterprise NPR Opening at 5-7; TFI NPR Opening at 11.

32 *See* STB Docket No. 41242, *Central Power & Light Co. v. Southern Pacific Transportation Co.* (served Dec. 31, 1996), *clarified* (served April 30, 1997), *aff'd sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999), *cert. denied*, 120 S. Ct. 372 (1999); *Union Pacific Railroad Co. v.*
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impose conditions in future merger cases to ensure that otherwise available relief under the "contract exception" is not eroded as a direct result of a railroad merger. *See* NS ANPR Reply at 34 n.27. The Board's proposed rules implement this consensus approach by requiring future merger applicants to address how their proposed transaction would preserve "the opportunity to enter into contracts for one segment of a movement as a means of gaining the right separately to pursue rate relief for the remainder of the movement." NPR at 14-15 (proposed § 1180.1(c)(2)(i)). NS supports this approach. In their opening comments, however, a number of parties have again proposed that the Board should use this rulemaking proceeding to overrule its "bottleneck" rule, and to require merger applicants (if not all railroads) to establish separately challengeable rates between any two points on their rail systems.[33] As previously explained, these proposals are not merger-related, and are unsound both as a matter of law and policy. *See* NS ANPR Opening at 49-50.

(4) Preservation of Existing Interchange Rights. The Board's proposed rules require careful assessment of the potential competitive and other impacts of a proposed major rail consolidation on Class II and Class III rail carriers, and specifically require applicants to address how their proposed transaction would preserve existing competitive options for smaller

[32](...continued)
STB, 202 F.3d 337 (D.C. Cir. 2000).

[33] *See, e.g.*, DuPont NPR Opening at 5; ACC NPR Opening at 6, 8; CCS NPR Opening at 13-16; PPG NPR Opening at 2; CURE NPR Opening at 4-5, 8-9; EEI NPR Opening at 6-8; SCS NPR Opening at 16-18.

carriers.[34] NS supports these proposed rules because they allow flexible, case-by-case examination of a transaction's effects on smaller railroads. NS NPR at 60-61.

In adopting these flexible rules, the Board rejected the demands by short-line railroads, shippers and some government agencies for adoption of a variety of rules (including ASLRRA's self-servingly described "Bill of Rights") that would abrogate private contracts between major rail carriers and various short-lines, interject new and burdensome regulations governing the relationship between large and small carriers and effectively insulate short-lines from competitive market forces. As NS has previously explained, these proposals are not merger-related, are wrong-headed in any event, and were properly rejected by the Board.[35]

One of the proposals raised by short-line railroads and their supporters relates to so-called "paper barriers," which are contractual provisions -- voluntarily negotiated as part of the agreement under which the short-line railroad acquired its rail line from a major railroad -- governing a short-line railroad's obligation or right to interchange traffic with other railroads. Many commenters have again demanded that the Board require merger applicants to abrogate existing "paper barriers" and prohibit them prospectively, both in railroad line sale agreements and in inter-carrier trackage rights agreements.[36] These proposals are unsound. They seek to abrogate lawful private contracts for reasons unrelated to any competitive or other impacts of a

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34 *See, e.g.*, NPR at 15 (proposed § 1180.1(c)(2)), 16 (proposed § 1180.1(d)), 19 (proposed § 1180.1(h)(1)), 30-31 (proposed § 1180.6(b)(10)), 32-33 (proposed § 1180.7(b)), 35 (proposed § 1180.10(a)).

35 *See, e.g.*, NS ANPR Opening at 53-55; NS ANPR Reply at 52-54; NS NPR Opening at 60-61.

36 *See, e.g.*, ASLRRA NPR Opening at 3; CCS NPR Opening at 18-19; CURE NPR Opening at 9; EEI NPR Opening at 8-9; MW&BC NPR Opening at 5; State of New York NPR Opening at 14-18; PPL NPR Opening at 15-18; SCS NPR Opening at 18-19; ODOT NPR Opening at 8-11.

proposed rail consolidation, and would simply discourage future line sale transactions that could save marginal rail lines from abandonment. Regulatory abrogation of these contractual interchange provisions, which typically form an essential component of the consideration (purchase price) for a railroad line sale transaction, would entail improper agency interference in private contractual matters. NS agrees, however, that there may be some instances in which the effect of a proposed rail merger may be to expand the reach of a "paper barrier" obligation imposed on a short-line railroad's traffic interchanges. In such cases, which would involve genuine merger-related impacts, some limited relief in the context of a major rail consolidation proceeding might be warranted, as the Board has found in prior merger proceedings.[37] The Board's proposed rules would permit case-by-case consideration of these issues, and proposed remedial measures, and are more than sufficient to address any issues relating to the preservation of short-line railroads' existing interchange rights.

(5) "One-Lump" Doctrine. During the ANPR comment process, a number of shipper interests urged the Board to abrogate its "one-lump" doctrine, which provides that, in the absence of contrary evidence, an exclusively served rail shipper does not suffer competitive harm when the serving railroad merges with a connecting rail carrier in a purely vertical, or end-to-end, combination.[38] Although the Board declined to adopt this suggestion, several commenting parties have renewed their request and again ask either that the Board expressly abrogate the

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[37] *See* NS ANPR Opening at 55 n.44 (citing *Conrail Control,* Decision No. 89 (served July 23, 1998), at 76-77; *BN/Santa Fe,* Decision No. 38 (served Aug. 23, 1995), at 94).

[38] *See, e.g., Conrail Control,* Decision No. 89 (served July 23, 1998), at 67-70, 78; ICC Finance Docket No. 32549, *Burlington Northern Inc. -- Control & Merger -- Santa Fe Pacific Corp.*, Decision No. 38 (served Aug. 23, 1995) ("*BN/Santa Fe*"), *aff'd sub nom. Western Resources, Inc. v. STB*, 109 F.3d 782 (D.C. Cir. 1997).

doctrine or require that prior precedent and agency analysis of the issue be ignored in deciding in future cases whether to apply the doctrine.[39] These proposals have no more merit now. As NS has previously explained, the "one-lump" doctrine is supported by well-established economic principles and has been sustained by the courts. Moreover, the doctrine erects no insuperable barrier to the assertion of claims of anti-competitive vertical foreclosure, which should -- as the Board's proposed merger rules would allow -- be considered in individual cases on the basis of specific evidence.[40]

II. ASSESSMENT OF PUBLIC BENEFITS

In light of the size, significance and potential risks that may be associated with major rail mergers in the future, the Board has proposed to give increased scrutiny to claimed merger-related public benefits, and to require applicants to make a more convincing showing regarding such benefits, than has been customary in the past. NPR at 14. Most commenters, including NS, support this approach. *See* NS NPR Opening at 18-21, 36. In applying such enhanced scrutiny, however, the Board should not prejudge the issue of whether rail mergers generally will produce net public benefits. Rather, the Board should continue to examine each proposed transaction on its own merits, on the basis of the evidence presented, in order to determine whether the proposed transaction is consistent with the public interest. *Id.* at 18-21.

In addition to applying enhanced scrutiny of claimed merger benefits and requiring applicants to make a more convincing showing of such benefits, the Board's proposed rules also

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39 *See, e.g.*, CCS NPR Opening at 13-16; IMPACT NPR Opening at 27-28; Dow NPR Opening at 10-12; EEI NPR Opening at 10; NITL NPR Opening at 7-8; TFI NPR Opening at 6.

40 *See* NS ANPR Opening at 33-34; NS ANPR Reply at 34-37.

would require applicants to propose "additional measures" that the Board could impose "if the anticipated public benefits fail to materialize in a timely fashion." NPR at 14. A number of commenters have urged the Board to go further still, seeking punitive measures and "penalties" to be applied if merger applicants fail to attain all of the public benefits predicted in a merger application.[41]

NS does not support the Board's proposal to require merger applicants to propose "additional measures" to be imposed if anticipated public benefits do not materialize "in a timely fashion." NS also opposes efforts by some shippers to impose "penalties" on merging railroads if they fail to achieve all of the public benefits within the time period projected in their application. These proposals misconceive the fundamental nature of the merger planning process, and ignore its inherent limitations.

The public benefits estimated in rail merger applications represent good faith estimates of the probable effects of a proposed merger. These estimates, however, are not forward-looking "projections" of the results of future years' rail operations. Such forward-looking projections would require analysis of a myriad of varying macroeconomic factors and potential operating conditions that are too complex for precise mathematical modeling. Rather, the public benefits estimated in rail merger applications are based on static analysis of a single base year's data. Merger applicants then adjust the base year's data to reflect the impact of the proposed merger, demonstrating how rail operations in the base year would have varied if the proposed transaction had been in effect in that year. This focus on historical data is intended to permit effective regulatory review by isolating the likely effects of a proposed merger, without

[41] *See, e.g.*, ARC NPR Opening at 5; CPUC NPR Opening at 5-6; MW&BC NPR Opening at 4.

attempting to consider innumerable "what-ifs" that would needlessly complicate the analysis. In other words, rail merger applicants do not attempt to incorporate the effect of constantly changing economic conditions in estimating the public benefits of a proposed transaction. But the fact that changing economic conditions are ignored for purposes of regulatory review does not mean that they do not occur in the real world. Thus, it is unrealistic and unfair to attempt to use the public benefits estimated in a merger application, calculated from a single base year's data, as a yardstick by which to measure the merged entity's actual performance in later years, under different macroeconomic conditions.

For these reasons, the good faith estimates of public benefits contained in merger applications are not intended and should not be viewed as guarantees of a merged company's future financial and economic performance. A rule that would require applicants to guarantee that a proposed transaction will succeed in producing all of the expected benefits, and that it will do so on a particular timetable, would impose an impossible burden of omniscience on the applicants. No other regulatory regime governing complex transactions in any other industry imposes such a burden.

The Board's stated reason for considering such an approach is to ensure that applicants "have no incentive to exaggerate" the public benefits expected from a proposed transaction. NPR at 14. Other parties commenting on this proposal have offered no rationale whatsoever for such an approach, but simply assume that rail merger applicants should guarantee the results of a proposed merger, and should pay a severe "penalty" if their estimates turn out to be imperfect. NS respectfully suggests that these concerns do not and cannot justify a requirement that merger applicants guarantee that a proposed transaction will produce the expected results with mathematical precision, and on a particular timetable.

As noted above, NS supports the Board's proposal to subject such estimates to increased regulatory scrutiny. NS also agrees that applicants should be required to make a more convincing showing of merger-related public benefits than has been expected in the past. Applications that fail to meet these heightened standards of regulatory review, or that offer exaggerated estimates of public benefits without evidentiary support, should be rejected. This increased regulatory scrutiny, and the possibility of rejection of an inadequately supported application, provide the proper incentive for rail merger applicants to calculate expected public benefits as accurately as possible, without exaggeration.

Moreover, rail merger applicants have every incentive to strive to achieve the public benefits they have estimated once a merger has been approved and a transaction has been consummated. The railroad itself will bear the brunt of failure if it cannot implement the transaction successfully and efficiently. While individual rail shippers certainly can be adversely affected by service difficulties, it is the railroad itself that will suffer first and foremost from such merger implementation problems.

In any event, if merger implementation difficulties arise despite the applicants' best efforts, or if economic and operating conditions change in ways that hinder the new carrier's performance, there is no reason to believe that the application of "additional measures" imposed by the Board as part of its regulatory oversight will immediately lead to improved results. To the contrary, the anticipated public benefits of a merger can occur only as quickly as real world economic conditions permit. Public benefits cannot be created on demand, nor can they be dictated by regulatory or managerial fiat. Inflicting punitive measures or "penalties" on railroads that are already struggling to improve service difficulties, perhaps while suffering under economic conditions beyond their immediate control, will do nothing to hasten the achievement of public benefits and may well have the opposite effect. Thus, there are no additional regulatory measures that could guarantee that the expected public benefits of a proposed transaction will always materialize on schedule, regardless of intervening events. NS respectfully requests that the Board refrain from imposing such an impossible burden on merger applicants.

NS believes, however, that the Board does have a proper role in monitoring the implementation of an approved consolidation and assessing whether projected public benefits are being realized. As NS explained in its opening comments, it would be appropriate to require merger applicants during post-implementation oversight proceedings to submit evidence that the merger benefit projections accepted by the Board have been realized in a timely fashion or that the failure to realize them is not the result of any *unreasonable* failure by the applicants to implement the approved transaction or fulfill any of the specific commitments made during the approval process. *See* NS NPR Opening at 44-45 & Attachment A at 66 (proposed § 1180.1(c)(1)), 69 (proposed § 1180.1(g)). This approach, which is similar to suggestions made by other parties,[42] properly balances the Board's interest in promoting the achievement of the projected public

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[42] For example, on the issue of monitoring realization of public benefits, UP took a position similar to that of NS and suggested that the following language be added to proposed § 1180.1(g)): "The Board recognizes, however, that applicants require the flexibility to adapt to changing circumstances and that it is inevitable that their merger will not be implemented in precisely the manner anticipated in the application. Applicants therefore satisfy their obligation by demonstrating that they acted reasonably in light of changing circumstances." UP NPR Opening at 18. Like NS's proposal, UP's proposed revision would properly hold applicants to a standard of reasonableness in implementing their approved consolidation and realizing the projected public benefits originally identified in their merger application.

benefits that formed a basis for its approval of a proposed consolidation with the inherent nature of merger projections and merger implementation.

III. ALLIANCES AND JOINT VENTURES

Numerous parties have commented on the issue of whether and how to assess claimed merger-related benefits that might be achieved by means short of a merger (*i.e.*, through inter-carrier alliances, joint ventures, operating agreements, and so on). The existing merger rules provide that in conducting its public interest analysis, the Board "will consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public." 49 C.F.R. § 1180.1(c). The Board's proposed rules essentially would retain this language, and would add language noting the Board's belief that "other private sector initiatives, such as joint marketing agreements and interline partnerships, can produce many of the efficiencies of a merger while risking less potential harm to the public." NPR at 12 (proposed § 1180.1(c)).

In its opening comments, NS stated its agreement with the principle that some of the benefits traditionally associated with mergers could potentially be achieved today through means short of a merger. *See* NS NPR Opening at 39. NS noted, however, that the language of the existing rule properly states the appropriate analysis, and that the additional language proposed by the Board could convey the impression that the Board has prejudged the issue. NS proposed that the existing rule could be applied more rigorously in future proceedings, and suggested that no textual change in the existing rule was needed. *Id.*; *see also* NS ANPR Opening at 14-16.

In other opening comments, several parties have argued that the Board's proposed language expresses an unwarranted preference for alliances, which they believe may prove to be anti-competitive. Several such parties have urged the Board to conduct a more probing review of such agreements, arguing that they are not subject to scrutiny under the antitrust laws, and that the Board therefore must assert its jurisdiction over such arrangements. Some parties expressly have urged the Board to expand its merger rules to include alliances.[43]

These concerns are unfounded. Under current law, the Board clearly has jurisdiction over agreements between carriers involving either control or pooling, as those terms are defined in the statute and case law. *See* 49 U.S.C. §§ 11322-11323. Otherwise, inter-carrier agreements that are not within the Board's jurisdiction are fully subject to scrutiny under the antitrust laws.[44] If a particular alliance or joint venture raises antitrust or competitive concerns,

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[43] *See, e.g.*, ACC NPR Opening at 11-12; Dow NPR Opening at 20-22; DuPont NPR Opening at 3, 7-8; NITL NPR Opening at 27-30; ARC NPR Opening at 4; ORDC NPR Opening at 16.

[44] In particular, at least one commenter has expressed concern that greater regulatory scrutiny of rail carriers' actions in setting joint rates is needed in the context of carrier alliances, and that the Board should consider requiring carriers involved in alliances to seek collective ratemaking authority. *See* ACC NPR Opening at 11-12. These arguments are baseless, because carrier alliances typically do not involve collective ratemaking, as that term is properly understood. Carrier alliances typically involve the establishment of through rates for end-to-end movements over two or more carriers. Whether such rates are established in a carrier alliance, or in a conventional joint rate arrangement between carriers, the actions of carriers in setting through rates for end-to-end movements typically do not implicate competitive concerns, because each carrier in a joint rate setting provides an individual component of a through service. No collective ratemaking is involved. Unlike class rates established by rate bureaus (which are subject to strict regulatory requirements and scrutiny under 49 U.S.C. § 10706), carrier alliances (and conventional joint rate arrangements) do not involve the establishment of uniform rates for similar services. To the contrary, carrier alliances permit individual carriers to extend their competitive reach and compete more effectively for traffic originating or terminating at points beyond their own lines. Such alliances often involve the grant of independent ratemaking authority, permitting individual carriers to establish competitive rates for through movements without the need to

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existing law provides ample tools to address such concerns. In any event, inter-carrier alliances do hold significant promise in enhancing competition and efficiency, and should not be discouraged by arbitrary rules based on unsubstantiated suspicions. Alliances may not make future major rail consolidations unnecessary, but unquestionably they may prove to be vehicles for achieving some efficiencies and other public benefits that otherwise could be realized only through formal merger. Particularly if the Board is proposing to apply a more stringent standard for merger approval, it should not at the same time discourage arrangements that may provide the only means by which some of the types of public benefits obtainable through merger could be realized.

IV. SERVICE ASSURANCE AND MERGER IMPLEMENTATION

In light of serious transitional service problems that occurred during the implementation of several recent rail mergers, the Board properly has focused much of its attention in this proceeding on rail service issues and, in particular, on how to avoid similar service disruptions in future rail mergers. The Board has proposed several constructive measures, including a requirement that merger applicants develop and implement a "service assurance plan" ("SAP") intended to minimize or eliminate such service disruptions, and a process of operational monitoring designed to assist the applicants in identifying and responding promptly to any service problems that may arise.

NS generally supported the Board's service-related proposals, including the SAP procedures, which establish a formal process requiring applicants to address service issues and potential service problems in advance, and which provide interested parties an opportunity to

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[44](...continued)
obtain the concurrence of the participating carrier for each and every rate quotation. Such arrangements are unambiguously pro-competitive, and do not require greater regulatory scrutiny.

comment on the applicants' service plans. By establishing formal procedures for service-related planning, the SAP process can assist the applicants in anticipating and avoiding potential service problems. The process also provides the opportunity for a constructive dialogue among the applicants, shippers and other interested parties on service-related issues. As NS noted in its opening comments, however, the SAP process can only be productive if the SAP itself is regarded as an "evolving, organic document" that can and must be revised and updated in response to changing traffic and market conditions and unanticipated developments or problems. NS NPR Opening at 47. NS noted that a static operating plan premised on a prior "base" year's traffic data cannot provide a complete and comprehensive blueprint for the implementation of a complex transaction in subsequent years, under varying economic and operating conditions. *Id.* Thus, NS urged the Board to ensure that the SAP process would not become a regulatory straitjacket, preventing railroads from responding appropriately to evolving operating conditions and unanticipated problems. *Id.* NS also urged the Board to retain flexibility in its operational monitoring requirements, reflecting the fact that railroads maintain different types of operating data ("metrics") in differing formats. *Id.* at 47 n.20.

In contrast to the comments of NS and other railroads, which emphasized the importance of flexibility in the SAP process, many commenting parties apparently seek to use the SAP process as a means of forcing railroads to establish ironclad service commitments and guarantees that could not be modified or adjusted under changing conditions. This distortion of the SAP process might serve the interests of shippers seeking to preserve the status quo, but it would do nothing to avoid or resolve service problems, and it would actively frustrate the efforts of railroads to respond to changing conditions and unanticipated events arising during the merger implementation process.

Other commenting shippers (and also short-line rail interests) have focused on proposals to create new procedures for handling claims for damages arising out of merger-related service problems, including unprecedented claims for consequential damages, to be administered by the Board, in addition to its other merger oversight responsibilities.[45] All of these proposals had been raised during the ANPR comment period, and the Board declined to adopt them in its proposed new merger rules. Even if these proposals for new remedial rules were properly subject to consideration at this stage of the rulemaking process, the Board should again reject them for several reasons.[46]

First, as noted above, these proposals will do nothing to avoid or correct rail service problems, and may exacerbate them, by imposing a regulatory straitjacket on railroad operations at times when operational flexibility may be essential to avoid a rail service crisis.

Second, such proposals are not necessary to provide an "incentive" for railroads to avoid service problems. Railroads already have powerful economic incentives to avoid service problems, because the costs of such problems fall first and foremost on the railroads themselves. NS and CSX faced enormous financial costs associated with the service problems that arose in

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[45] *See, e.g.*, ACC NPR Opening at 13-14; ASLRRA NPR Opening at 3, 8; CCS NPR Opening at 16-18; IMPACT NPR Opening at 16-18; Dow NPR Opening at 9-10; EEI NPR Opening at 11-12; MW&BC NPR Opening at 6; NITL NPR Opening at 20-24; NMA NPR Opening at 2;PPG NPR Opening at 2; DOA NPR Opening at 19; SCS NPR Opening at 20-23.

[46] *See* NS ANPR Opening at 20-24; NS ANPR Reply at 28-31.

connection with the Conrail transaction, and UP likewise faced enormous costs arising from its service difficulties in the UP/SP transaction.

Third, existing law provides appropriate remedies for rail service failures. Shippers are entitled to seek damages in court under current law when railroads fail to comply with their common carrier service obligations. Shippers using rail transportation contracts have the opportunity to negotiate specific agreed service levels and commitments which railroads must meet and remedies (including, potentially, monetary damages of various types) if railroads fail to live up to these service commitments. In addition, the Board's emergency service rules (as developed in the Ex Parte 628 proceedings) provide flexible administrative remedies with which the Board can expeditiously address serious service problems or failures.[47] None of the commenting parties have shown that these existing remedies are in any way inadequate.

Fourth, the Board's statutory mandate does not extend to the resolution of purely private disputes involving claims for damages arising out of rail service complaints. Moreover, the Board itself has limited administrative resources, and is not well-equipped to address and resolve the large numbers of fact-intensive disputes that would inevitably arise under the procedures advocated by some shippers. Resolving such disputes on a timely basis would be particularly difficult, given that the Board no longer has the assistance of full-time Administrative Law Judges.

Finally, proposals seeking to require railroads to guarantee particular service levels, and imposing strict financial penalties for any service lapses during a merger implementa-

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47 *See* STB Ex Parte No. 628, *Expedited Relief for Service Inadequacies* (served Dec. 21, 1998) (codified at 49 C.F.R. §§ 1146-1147).

tion period, would constitute a fundamental restructuring of rail industry economics. Such proposals seek to reallocate all of the risks of service problems, making railroads virtual insurers of current service levels, without recognizing the costs inherent in such an approach. Current rail rates reflect the fact that railroads are required to provide common carrier service with reasonable dispatch, but are not required to insure particular service levels regardless of circumstances. Changing this economic bargain, and requiring railroads to insure current service levels, would impose additional costs that could only be recovered through higher rail rates. Higher rates, however, would result in the loss of competitive traffic, ultimately requiring even larger rate increases for less competitive traffic. Denying railroads the right to recover these increased costs would deter and ultimately prevent efficiency-enhancing rail mergers that could otherwise permit more competitive, lower-cost service for all shippers. Thus, proposals to require railroads to insure current service levels would be counterproductive and ultimately self-defeating. The Board should continue to reject such proposals.[48]

Although NS firmly believes that mandated service guarantees and creation of new remedial mechanisms for merger-related service disputes would be unsound as a matter of law and policy, NS is sensitive to the need for rail merger applicants to provide shippers and other affected interests greater assurances that proposed major rail consolidations will not result in serious service disruptions. Rather than dictate arbitrary guarantees that may discourage and prevent

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[48] Proposals to require penalties or recovery of consequential damages for particular merger-related reductions in rail service also overlook the need for the Board to weigh benefits and harms in judging whether a proposed consolidation is in the public interest. For example, if a proposed merger would significantly improve service for thousands of shippers, but produce service reductions for a tiny handful, the transaction would be in the public interest and should be approved, regardless of the isolated service reductions.

otherwise beneficial rail merger proposals, the Board's rules should encourage applicants to come forward with proposals to assure service, and those proposals should be given significant weight in the merger-review process.[49]

As noted above, NS generally supports the Board's proposals for operational monitoring of rail mergers during the oversight period. Some commenters, however, are requesting that the Board establish specific, detailed requirements for the types of operating data that must be provided by the applicants and by the merged entity following consummation of a transaction, including transit times for particular corridors and origin-destination pairs, for example.[50] As NS stated in its opening comments, however, it is essential that the Board retain flexibility in its operational monitoring requirements, in order to permit applicants to provide the best available data that can be obtained from their respective information systems, which contain differing types of data in different formats. The Board should not impose "one-size-fits-all" requirements, which may prove impossible to meet, or which may hinder applicants from developing the most appropriate and useful types of data that can be provided.[51]

V. OVERSIGHT ISSUES

NS continues to support the Board's proposal to formalize and codify its practice of imposing oversight conditions in approving major rail consolidations, including its adoption of

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49 *See* NS NPR Opening, Attachment A at 76 (proposed § 1180.6(b)(10)(ii)); NS ANPR Reply at 30-31.

50 *See, e.g.*, NITL NPR Opening at 24-26; DOA NPR Opening at 22; TFI NPR Opening at 11-12; DOT NPR Opening at 12.

51 *See also* BNSF NPR Opening at 51 (applicants should propose in the first instance the data points to be monitored post-merger).

a five-year formal oversight period.[52] As noted in its opening comments, NS believes that oversight monitoring must be focused on the applicants' efforts to achieve the public service benefits described in their application. In assessing these efforts, the Board should examine whether the applicants have unreasonably failed to implement the approved transaction, and whether they have fulfilled the commitments they made during the merger review process. *See* NS NPR Opening at 48-49. As described above, while it is appropriate to assess whether the expected public benefits of the merger have been achieved, it is not appropriate to regard the applicants as insurers of these public benefits, or to impose punitive measures or "penalties" on the applicants simply because these public benefits may not have materialized as expected. In particular, the applicants should not be penalized if the expected public benefits of a merger have not been achieved because of changing economic conditions or other unanticipated events beyond the applicants' control.

As noted in its opening comments, NS fully supports the Board's authority to remove or modify conditions imposed on a merger, if it determines that the conditions are no longer necessary or are no longer achieving the intended effects. NS NPR Opening at 49-50. The standard for modification of a previously imposed condition should be whether it has achieved its intended purposes or must be changed to ensure its effectiveness in remedying the particular

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[52] A few parties have suggested that the Board's oversight monitoring should continue beyond a five-year period. *See, e.g.*, ARC NPR Opening at 4; CPUC NPR Opening at 4; DuPont NPR Opening at 8. This suggestion should be rejected. Five years is more than sufficient time in which to assess the effects of a railroad consolidation. By the end of the five-year period, the rail consolidation would be fully implemented, and changes in the carrier's operations and services would be affected far more by changing economic and business conditions than the terms of the earlier consolidation.

problem or harm it was originally intended to address.[53] NS also believes that the Board should not impose additional conditions, after a merger has been consummated, solely to remedy "unforeseen consequences" of a merger, or in response to other unanticipated events. *Id.* NS has proposed one specific revision to the Board's proposed rules, indicating that the Board "will not use the oversight process to impose new conditions that would have the purpose or effect of restructuring the original approved transaction to address post-approval changes in market structure or competitive conditions unrelated to the original transaction." *Id.* at 50 & Attachment A at 69 (proposed § 1180.1(g)). More generally, NS concurs with the analysis offered by other commenting parties, indicating that the Board generally lacks authority to impose entirely new conditions after a merger has been consummated.[54]

VI. CUMULATIVE IMPACTS AND CROSSOVER EFFECTS

NS continues to support the Board's proposal to repeal its "one case at a time" rule, and to consider so-called downstream, cumulative and crossover impacts of proposed mergers, including potential rail mergers that may be proposed in response to a particular transaction. NS NPR Opening at 51. As noted in its opening comments, however, NS believes it would be impracticable and unproductive to require applicants to prepare alternative merger impact analyses for every potential combination of hypothetical transactions that could be proposed in response to the transaction under review. *Id.*

Other commenting parties have proposed a variety of approaches to the problem of predicting downstream effects. A number of parties have pointed out the difficulty of

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53 *See, e.g.*, UP NPR Opening at 6 n.2; BNSF NPR Opening at 54-55.

54 *See, e.g.*, UP NPR Opening at 5-7; BNSF NPR Opening at 46-49.

attempting to predict future transactions.[55] Others have suggested that analysis of downstream effects should focus generally on the possibility that further rail mergers will lead to a rail system composed of two large transcontinental rail carriers.[56] And others have suggested even more grandiose approaches, such as a Board-commissioned expert study of downstream effects or a regulatory edict commanding the major railroads immediately to join together in devising a "final solution" for the U.S. rail industry structure.[57]

NS continues to believe that applicants should attempt to address the probable downstream effects of a proposed merger, including likely responses by other carriers. In particular, NS agrees that applicants should address the likely effects of any other merger that is actually proposed in response to a particular transaction (*see, e.g.* BNSF NPR Opening at 43). Applicants also should respond to particular issues regarding downstream effects that are actually raised by participants in a proceeding. Apart from addressing such particular issues, however, NS also continues to believe that it would be impractical -- and as well probably unhelpful in the final analysis of a proposed consolidation -- to require applicants to conduct multiple, hypothetical analyses of the various effects on public benefits that could result from potential responsive transactions. Rail merger proceedings are complicated enough without injecting limitless speculation about the effects of hypothetical future transactions.[58]

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55 *See, e.g.*, UP NPR Opening at 3-7; BNSF NPR Opening at 43-45; CP NPR Opening at 16-19; BASF NPR Opening V.S. O'Connor at 23.

56 *See, e.g.,* UP NPR Opening at 3-7.

57 *See, e.g.*, ORDC NPR Opening at 12; PPG NPR Opening at 3.

58 Some parties have suggested that the Board could address potential downstream effects with "springing" merger conditions, which would impose on an applicant various obligations if and when some (continued...)

Some commenting parties have suggested that the Board should also consider modifications of conditions previously imposed in other merger proceedings, as part of an analysis of so-called "upstream effects." NS believes that it is appropriate to consider whether previously imposed conditions may no longer be necessary in light of subsequent transactions, and whether such previously imposed conditions therefore should be modified or removed. In assessing the merits of a proposed transaction, it is also appropriate to consider its effects on prior transactions, including effects on merger conditions imposed on prior transactions. For example, if a proposed consolidation would have adverse effects on the effectiveness of a competition-preserving condition imposed in a previous merger proceeding, it would be within the Board's authority (if practicable) to condition its approval of the *subsequent* transaction on measures to preserve the effectiveness of the prior condition.[59] It would not be appropriate in this situation, however, for the Board to reopen the *prior* merger proceeding and impose new or different conditions designed to address effects of the later merger proposal. Nor, for that matter, would it ever be appropriate for the Board to use a pending rail merger proposal as a vehicle for reopening prior merger proceedings involving the applicants and either subjecting those concluded merger proceedings to new rules and standards or imposing new conditions not originally justified by the record of the prior proceeding.[60]

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[58](...continued)
other, future consolidation is proposed and implemented. *See, e.g.*, DuPont NPR Opening at 5. The imposition of such conditions is both unwise and of dubious legality. *See* UP NPR Opening at 5-7. For present purposes, however, this issue is one that should (if at all) be addressed in the context of a particular rail consolidation proposal, not in the Board's proposed new merger rules.

[59] *See, e.g.*, UP NPR Opening at 6-7 & n.3.

[60] The Board should therefore reject KCS's proposal for a rule expressly authorizing the Board to
(continued...)

VII. TRANSNATIONAL ISSUES

NS continues to support the Board's proposal to require applicants in proposed cross-border transactions to submit "full system" operating plans and competitive impact analyses, in order to permit the Board to assess all transaction-related impacts within the United States. NPR at 21; *see* NS NPR Opening at 52. Virtually all commenting parties agree on this proposal.

The Board has also proposed additional requirements for proposed cross-border transactions, including a requirement that the applicants address so called "foreign control" issues, including the possibility that the merged entity could be operated in the interests of a foreign government, or foreign shareholders, to the detriment of United States shareholders or the U.S. national interest. These proposals elicited considerable comment from various parties. As stated in its opening comments, NS continues to believe that these rules are not necessary, and that any particular concerns regarding the transnational, national defense or cross-border safety impacts of a proposed rail consolidation can be adequately addressed in the context of the Board's general merger rules. NS NPR Opening at 52-53.

VIII. SHORT-LINE AND REGIONAL RAILROAD ISSUES

As NS noted in its opening comments, short-line and regional railroads play an important role in meeting the Nation's needs for rail freight transportation services. All Class I

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[60](...continued)
"remedy" competitive harms allegedly resulting from prior, approved railroad mergers whenever the parties to those consummated mergers happen to be applicants in a subsequent rail consolidation proposal. KCS NPR Opening at 8-11, 12-13. Similarly, the Board should adhere to its position -- reaffirmed just last week in another case -- that the proposed new merger rules will have only prospective effect. NPR at 9; STB Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corp. -- Control & Merger -- Southern Pacific Rail Corp. [General Oversight]*, Decision No. 16 (served Dec. 15, 2000), at 12 (concluding that one party's "suggestion to apply retroactively our newly proposed merger guidelines to mergers that have already received our approval is clearly inappropriate"); *see also* UP NPR Opening at 5-7.

rail carriers (including NS) have a strong interest in promoting the development of viable short-line and regional railroads whose operations are supported by market conditions. It is therefore entirely appropriate that the Board, in assessing the effects of a proposed major rail consolidation, consider potential adverse effects of the transaction on smaller carriers. The Board's proposed rules include a number of new provisions that would require merger applicants, and the Board, to assess impacts on smaller carriers. *See* note 34, *supra*. These proposals are sound, and NS supports them. NS NPR Opening at 61.

A number of short-line railroads, and other parties supporting them, are not satisfied with these proposed rules. Repeating proposals unsuccessfully offered during the ANPR comment process (and in other proceedings and forums), various parties again have proposed a number of new merger rules aimed at providing special protections to short-line and regional railroads. In addition to demands for service guarantees and compensation for merger-related service disruptions (which raise essentially the same issues previously discussed in connection with service assurance), short-lines and their supporters have proposed rules requiring the abrogation of voluntarily negotiated contractual provisions governing the interchange of traffic between short-lines and other independent carriers (so-called "paper" and "steel" barriers), and various pricing, access and car supply guarantees.[61]

As NS has previously explained, these short-line measures (with limited exceptions) are transparently protectionist and -- as DOT has noted (DOT ANPR Opening at 23-24)

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[61] *See, e.g.*, ASLRRA NPR Opening at 3; FMRC NPR Opening at 6-7; State of New York NPR Opening at 14-18; CCS NPR Opening at 18-19; ODOT NPR Opening at 8-11; HRC NPR Opening at 5, 10-11; CURE NPR Opening at 9; EEI NPR Opening at 8-9; PPL NPR Opening at 15-17; SCS NPR Opening at 18-19; MW&BC NPR Opening at 5.

-- are unrelated to the impacts of rail consolidations.[62] There is no justification for adopting these proposals as requirements for future rail consolidation proposals. For example, the proposal to abrogate contractual provisions in railroad line sale agreements governing interchange of traffic is nothing more than an attempt to nullify essential terms (including price) of fairly negotiated commercial agreements. Provisions in line sale agreements requiring the short-line purchaser to interchange specified volumes of traffic with the selling carrier form an integral component of the consideration (*i.e.*, purchase price) for the line sale, as the revenues earned by the selling carrier from post-sale traffic interchanges serve to defray the purchase price of the line. In effect, the interchange commitments are a means of effectuating payment of the agreed purchase price of the rail line. These interchange provisions are not only unrelated to any genuine merger impact, but their abrogation by regulatory order would be inappropriate and unfair, and very likely would work an unconstitutional taking of property.

In any event, the various protectionist proposals offered by the short-line rail interests (including most elements of the so-called short-line "Bill of Rights" advocated by ASLRRA and supported by some parties) involve longstanding commercial issues between the major railroads and smaller carriers. These issues have been, and continue to be, the subject of active, productive negotiations. As the Board has previously found, these issues should be resolved through private-sector negotiation and, particularly because they are unrelated to rail mergers, should not be addressed in the Board's proposed merger rules. The Board therefore

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[62] *See* NS ANPR Opening at 53-55; NS ANPR Reply at 52-54. One exception, previously noted here, involves situations in which a proposed rail consolidation might have the extent of expanding or extending the reach of certain pre-merger contractual restrictions on traffic interchanges. In those cases, as the Board has previously held, it may be appropriate to impose conditions to remedy this adverse effect on a short-line railroad. *See* pages 26-28, *supra*.

acted appropriately in declining to include these various protectionist measures in its proposed new merger rules.

There is, if anything, even less merit to various additional protectionist proposals that were raised by some short-line railroads in their opening comments. In particular, several short-lines urged the Board to adopt rules declaring that every short-line railroad is deemed to provide "essential services" within the meaning of the Board's merger policy statement. As if that were not enough, these parties further seek a rule providing that short-line railroads will be entitled -- whether or not there is any threatened harm to essential services -- obtain protective conditions whenever a proposed major rail consolidation would result in a short-line suffering *any* losses of traffic or revenues.[63] These proposals represent nothing more than an attempt to use the regulatory process to secure competitive advantages, and to insulate short-line railroads from normal competitive market forces. They should not be adopted.[64]

IX. PASSENGER RAIL ISSUES

Like smaller freight railroads, inter-city and commuter passenger rail operators represent an important component of our Nation's rail transportation system. In most cases, the relationship between freight railroads and passenger rail operators, and the sharing of rail lines by freight and passenger carriers, are governed by privately negotiated agreements between the

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[63] *See, e.g.*, ESHR NPR Opening at 4-5; FMRS NPR Opening at 7-8; HRC NPR Opening at 10; ODOT NPR Opening at 9-11.

[64] In support of its request for protectionist rules, HRC cites a recent *Traffic World* article attributing to NS official James W. McClellan certain statements about the effects of Class I rail carrier cost containment initiatives on the future viability of short-line railroads. HRC NPR Opening at 6 (citing *Traffic World*, Nov. 13, 2000, at 16). A subsequent article has clarified, however, that these statements were not even made by Mr. McClellan, but were actually made by a shipper representative and incorrectly attributed to Mr. McClellan. *See Traffic World*, Nov. 27, 2000, at 6.

freight railroads and passenger operators (including Amtrak and state or local government authorities that operate commuter rail services). These private sector agreements often include a negotiated allocation of responsibility for capital improvements, maintenance and other matters affecting the capacity of shared rail lines to serve the freight and passenger rail needs and the quality and level of services over those lines. Congress granted the Board no role in regulating the terms under which freight and passenger rail lines are shared.

The Board's proposed rules nonetheless properly require examination of a proposed major rail consolidation's effects on rail passenger operations. In particular, the proposed rules requiring applicants to submit a Service Assurance Plan specifically require analysis of merger impacts on passenger rail operators, and measures to minimize potential adverse impacts on passenger rail services during the merger implementation period. NPR at 35 (proposed § 1180.10(b)). NS believes these provisions are sensible, and should be adopted.

Unfortunately, however, some passenger rail interests appear determined to use this rulemaking proceeding, and the prospect of future major rail consolidations, as a vehicle for obtaining commercial concessions from the large freight railroads and for imposing on the freight railroads obligations that passenger rail operators have been unsuccessful in securing at the negotiating table. Among other things, commenters have proposed to the Board rules that, among other things, would (1) declare every government-subsidized passenger rail service to be an "essential service" triggering the right to protective merger conditions if such services were threatened by a proposed merger, (2) require protective conditions benefitting passenger rail operators even in the absence of any proper showing under the "essential services" standard, (3) authorize the Board to condition future major rail mergers on requirements that the applicants fund capital improvements for the benefit of passenger rail operators (regardless of existing contractual agreements allocating responsibility for such expenditures), and (4) require applicants to include passenger rail operators in preliminary analyses of proposed mergers.[65]

None of these proposals should be adopted.[66] All are protectionist in nature, and all seek to use regulation to alter the arms length negotiations between freight railroads and passenger rail operators over shared use of freight rail facilities. For example, the allocation of financial responsibility for expenditures to increase capacity as a result of fluctuating freight or passenger rail volumes over a particular line is a matter between freight railroads and passenger rail operators. The Board should not use its merger review authority as a vehicle for interfering with this process or rewriting the contractual commitments made by either party, a prospect that could well jeopardize the interests of the railroads' freight customers by reducing available rail capacity to serve their needs.[67]

X. PROCEDURAL SCHEDULE

The Board's existing rules governing review of major rail consolidations already provide for the longest and most intensive merger review process of any U.S. industry. The

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65 *See, e.g.*, MTA NPR Opening at 4-5, 7-8, 11-14; Metra NPR Opening at 1-2, 4-5; NJT NPR Opening at 5-8, 9-10; APTA NPR Opening at 2, 5-6; State of New York NPR Opening at 10-11; DOT NPR Opening at 11-12.

66 Some parties have requested that passenger rail interests should be represented on the Board's proposed Service Councils. *See, e.g.*, APTA NPR Opening at 4-5; NJT NPR Opening at 8 n.3. NS has no objection to such representation, but believes that the Board's merger rules should not adopt rigid rules regarding the composition of the Service Councils.

67 To the extent the passenger rail interests are suggesting that the Board could impose merger conditions requiring the freight railroads to provide passenger rail operators increased access and use of freight rail facilities, or compelling the freight railroads to undertake non-consensual investments in rail capacity, such an assertion of regulatory authority would raise serious issues of an unconstitutional taking of property in violation of the U.S. Constitution.

Board's proposed new merger rules would impose a variety of new evidentiary burdens on rail merger applicants and authorize more intensive scrutiny of various potential effects of major rail combinations. The desire to require ever more detailed evidentiary requirements and to apply ever closer scrutiny of railroad merger proposals is understandable, particularly given the temporary service problems that have accompanied recent major rail consolidation transactions. At the same time, however, the Board must be attentive to the serious risk that undue uncertainty and regulatory delay in the review of proposed rail consolidations may themselves discourage or prevent otherwise beneficial transactions. Regulatory costs are one important factor in decisions to propose efficiency-enhancing combinations, and those costs should not be so great as to prevent good transactions from even being proposed.

As several commenting parties have pointed out, other industries are subject to much shorter merger-review processes than the railroads, even for transactions that are as large or as significant in their effects on the public interest as major rail consolidations.[68] This procedural difference gives these other industries significant advantages over railroads in competing for scarce capital at reasonable cost. Regulatory delay in merger-review also imposes a variety of other costs, including postponement of the parties' individual decisions regarding commercial initiatives and capital investments, uncertainty among management and lower-level personnel and other concerns. Delay in the completion of merger review thus can even affect the vitality of competition in an industry.

The Board should therefore make every effort to minimize regulatory delay and to complete its future rail merger review proceedings within a period of time that is not significantly

[68] *See, e.g.*, BNSF NPR Opening at 19-21; CN NPR Opening at 10.

greater than the merger-review process governing other industries. NS has previously suggested that the Board adopt a "default" procedural schedule calling for completion of major rail consolidation proceedings within one year.[69] Other parties -- notably BNSF and CN -- have made a similar proposal.[70] NS strongly supports the proposal of a one-year merger-review process, which provides more than sufficient time for a careful and complete review of a proposed major rail consolidation.[71]

XI. FINANCIAL ISSUES

The Board's review of major rail consolidation proposals has always embraced issues and concerns regarding the financial impacts of a proposed combination, including the effects of the financial terms of the proposal on the applicant carriers' financial health, long-term viability and ability to provide safe, reliable and efficient service at reasonable, self-sustaining rates. Indeed, the statute governing the Board's review of major rail consolidations directs the agency to consider the proposed transaction's impact on the applicant carriers' ability to cover fixed charges and to provide adequate service (49 U.S.C. §§ 11324(b)(3)), and the agency's rail

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[69] *See* NS ANPR Opening at 66. Of course, adherence to such an expedited schedule should be conditioned on prompt completion of discovery and resolution of discovery disputes, and extensions of the schedule should be warranted if any party engages in dilatory discovery tactics.

[70] *See* BNSF NPR Opening at 8-9, 17-23, 58; CN NPR Opening at 10; *see also* CSX NPR Opening at 57-60 (suggesting that Board's merger-review process be shortened).

[71] Several parties proposed various other changes in the Board's rail merger procedures, including required local field hearings on rail merger proposals, required submission of rail merger proposals to FRA or independent consultants for separate review, creation of an office of public counsel to participate as an independent party in rail merger proceedings and other ideas. *See, e.g.*, Mankato NPR Opening at 4; ORDC NPR Opening at 13-16. These measures are unnecessary, and would only add another layer of burden, cost and uncertainty in the merger-review process. The Board has broad discretion to adjust its procedures in response to unique situations, and should address the need (if any) for specific additional procedures -- such as the scheduling of local field hearings -- on a case-by-case basis.

consolidation procedures have long required merger applicants to address these issues in their application. The Board's proposed new rules would not change this approach.

Nevertheless, a number of commenters have resurrected yet again proposals to adopt rigid rules excluding any so-called "acquisition premium" or any merger-related congestion costs from consideration in revenue adequacy and jurisdictional threshold determinations.[72] The arguments offered in support of these proposals have been made before and have consistently been rejected by the Board.[73] The Board's decisions on these issues reflect a straightforward application of generally accepted accounting principles, which the Board is directed by statute to follow. 49 U.S.C. § 11161. There is no basis, nor any reason, to revisit these issues in this proceeding. Parties concerned that the financial terms (including acquisition cost) of a proposed rail consolidation may be unreasonable, or may subject shippers to unreasonable rate increases, are certainly entitled to raise such issues in a merger proceeding and have their claims considered by the Board. Such issues should, however, continue to be addressed on a case-by-case basis on the strength of evidence directed to the specific concerns and issues raised.

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72 *See, e.g.*, EEI NPR Opening at 11; NITL NPR Opening at 26-27; DOA NPR Opening at 16-17; PPL NPR Opening at 13; SCS NPR Opening at 23-25; Dow NPR Opening at 18-19.

73 *See Conrail Control*, Decision No. 89 (served July 23, 1998), at 62-67 (rejecting proposed condition excluding "acquisition premium" from consideration in revenue adequacy and jurisdictional threshold determinations); STB Finance Docket No. 33726, *Western Coal Traffic League v. Union Pacific Railroad Co.* (served May 12, 2000), *reconsideration denied* (Nov. 30, 2000) (rejecting proposed condition excluding merger-related congestion costs from consideration in revenue adequacy and jurisdictional threshold determinations).

CONCLUSION

For all of the foregoing reasons, the Board should adopt amended major rail consolidation procedures and rules consistent with NS's foregoing comments.

Respectfully submitted,

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DATED: December 18, 2000

CERTIFICATE OF SERVICE

I hereby certify that, on this 18th day of December, 2000, I served the foregoing "Reply Comments of Norfolk Southern in Response to Notice of Proposed Rulemaking" by causing a copy thereof to be delivered by first-class mail, postage prepaid, to each of the persons listed on the Board's official service list in this proceeding.

Donald H. Smith

Donald H. Smith